BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268–0001

POSTAL RATE AND FEE CHANGES, 2000	Docket No. R2000–1

RESPONSE OF UNITED STATES POSTAL SERVICE TO QUESTIONS RAISED AT HEARINGS ON AUGUST 3, 2000

The United States Postal Service hereby provides its response to questions raised at the hearings on August 3, 2000 (witness Patelunas) at Tr. 35/16801-5, 16809 and 16810.

Each question is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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RESPONSE OF THE POSTAL SERVICE TO QUESTIONS OF COMMISSIONER LE BLANC AT THE HEARINGS OF 8/3/00 AT TR35/16801-5

In the cross-examination of Postal Service witness Patelunas, USPS-ST-44, on August 3, 2000, Commissioner LeBlanc asked the following questions as discussed in TR35/16801-5, 16809, and 16810. He provided the table from USPS-LR-I-420, section 2, page 1 (shown at TR35/16810) and noted that it showed "that the direct unit mail processing cost of Nonautomation Presort letters is about 2-3/4 cents, or if you will accept my math, about 40 percent higher than the benchmark Bulk Metered Mail." He pointed out that the "volume variable costs of processing [First-Class] Nonautomation Presort increased by roughly 25 percent" between FY1998 and FY1999. He also pointed out that "the cost of processing Standard A Regular Nonautomation letters also increased substantially by about 32 percent." He commented that "it appears that much of the increased cost occurred in a few cost pools which nearly doubled between '98 and '99, such as manual unit distribution and manual sorting [at] non MODS offices, among other things."

He provided the following questions:

a. [The above] would suggest that presort mail is more expensive to process than mail which is not presorted. Is this a result that one would ordinarily expect, would you think?
b. Was there some change in methodology, cost measurement technique or operational procedure for processing Nonautomation letters, which may have caused such a drastic increase?
c. If you assume this cost data is correct, accurate, is there something about the characteristics of Nonautomation Presort that would cause it to be more expensive to process than mail that is not presorted?
d. Is the Postal Service handling Nonautomation Presort in a new way that not only prevents it from taking advantage of the worksharing that has been done, but causes it to be more expensive than the nonworkshared mail?

RESPONSE:

As a preface to responding to these questions it is useful to summarize the changes in costs between FY1998 and FY1999, which are the basis for the differences in test year costs associated with Order No. 1294 as compared with our original filing. We concur with Commissioner LeBlanc's statement at

TR35/16803 that "the volume variable costs of processing BMM were fairly stable between '98 and '99." The volume variable labor processing cost of First-Class Nonautomation Presort letters did rise by 25 percent between FY1998 and FY1999, as indicated at TR35/16803. However, since Nonautomation volume went down by about 11 percent, the First-Class Nonautomation Presort letter processing labor unit cost rose by 41 percent. Likewise, the Standard A Regular Nonautomation Presort letter processing labor unit cost rose by 47 percent, also due to a combination of increased costs and lower volume. The processing labor unit costs for First-Class Cards, Nonautomation Presort and Standard A Nonprofit, Nonautomation Presort Letters also increased by 11 percent and 19 percent, respectively. Commissioner LeBlanc's statement that the increase appeared to be focused in a small number of cost pools is true for First-Class Nonautomation Presort letters, but this is not true for First-Class cards or the Commercial or Nonprofit Standard A categories.[1]

In general, the average of Automated and Nonautomated costs for letters and cards has not changed much between FY1998 and FY1999. Instead there has been a shift of costs from Automation to Nonautomation, leading to the rise in the nonautomation unit costs and the decline in the automation unit costs. As

[1] The FY1998 and FY1999 costs and volumes discussed above are provided in USPS LR-I-81 and USPS LR-I-415. FY1998 and FY1999 unit costs can be computed using the spreadsheets associated with these library references by removing the factors for test year adjustments (setting them to 1) and removing the piggyback factors (also setting them to 1).

discussed below in response to part b, there has been a change in the method used to develop the Automation/Nonautomation cost split. This methodology change is likely an important contributor to this shift in costs. This methodology change was intended to prevent an understatement of the Nonautomation costs. It may well have caused an overstatement of such costs as discussed below. The response to questions a, c, and d also is consistent with the notion that FY 1998 may understate Nonautomation costs, while FY 1999 may overstate them.

a.c.d. A comparison of the mail processing unit costs between nonautomation presort letters and Bulk Metered Mail (BMM) letters does not yield a cost difference due to presortation alone. The mail characteristics for these mail types are quite different.

For example, the First-Class Mail Characteristics study conducted in Docket No. R97-1 (USPS LR-H-185) showed that a fairly high percentage of nonautomation presort letters is nonmachinable. In other words, this mail is processed manually through the entire postal network. In the current docket, these mail characteristics data are included in the entry profile spreadsheets in witness Miller's testimony (USPS-T-24, Appendix I, page I-38). The entry profile spreadsheet shows that nearly 25% of nonautomation presort letters is entered directly into manual operations. In contrast, the vast majority of metered mail is machinable.

Of these machinable mail pieces, a lower percentage of nonautomation presort letters will be barcoded on automation. An Accept and Upgrade Rate Study was conducted in Docket No. R97-1 (USPS LR-H-130). This study showed that the encode rate (percentage barcoded) on the Multi Line Optical Character Reader Input Sub System (MLOCR-ISS) was 59.9% for nonautomation presort "OCR upgradable" letters and 52.0% for nonautomation presort "Non-OCR upgradable" letters. (The latter account for a third of the machinable Nonautomation letters.) The MLOCR-ISS encode rate for metered letters was 60.7%.

The same encode rate differences can be found on the Mail Processing Bar Code Sorter Output Sub System (MPBCS-OSS). The encode rate was 73.6% for nonautomation presort "OCR upgradable" letters and 68.7% for nonautomation presort "Non-OCR upgradable" letters. (The latter account for a third of the machinable Nonautomation letters.) The MPBCS-OSS encode rate for metered letters was 78.4%. Therefore, a greater percentage of the nonautomation presort machinable letters will ultimately be rejected on automation and processed in manual operations.

Witness Miller (USPS-T-24) relied on CRA-derived cost estimates for both the Bulk Metered Mail (BMM) letter benchmark and the nonautomation presort letters rate category. Despite this fact, he

developed nonautomation presort letters and metered letters cost models for comparison purposes. The model cost results were 6.296 cents for nonautomation presort letters (USPS-T-24, Appendix I, page I-4) and 5.269 cents for metered letters (USPS-T-24, Appendix I, page I-16).

Given these facts, it is not surprising that the savings due to presort in the nonautomation presort letters rate category is being offset by other factors. It is difficult, however, to determine the extent to which the nonautomation presort letters costs are changing over time because the mail characteristics studies have not been updated since Docket No. R97-1. It is possible that the percentage of nonautomation presort letters that are being processed manually has increased over the past few years. Postal Bulletin 22016 (1-27-00) announced that the Domestic Mail Manual (DMM) has been revised to allow mailers to specify that they want their mailings processed manually. They simply need to indicate "MANUAL ONLY" on the tray labels if this is their preference.

b. There was a change in the methods used to determine Automation and Nonautomation costs for FY1999 that may account for much of the cost differences between FY1998 and FY1999. The exact impact of this methodology change cannot be fully determined since we cannot control for any other changes that may have occurred between the two years.

Nevertheless, it does appear that the methodology change leads to a significant and sufficient magnitude of cost changes that it is likely the cause for much of the shift.

Furthermore, the methodology change was intended to prevent a potential understatement of Nonautomation costs. However, it may have caused an overstatement of Nonautomation costs. We are unable to determine the potential magnitudes of either the understatement of the FY1998 Nonautomation costs or the overstatement of the FY 1999 Nonautomation costs as discussed below.

The methodology change involved changes in data collected in IOCS as well as corresponding changes in the use of these data to determine if sampled pieces were Automation or Nonautomation. Two types of information are obtained from IOCS for this purpose. The first type of information is from IOCS question 23C, on piece markings, as shown in USPS LR-I-14, page 13-15. This question ascertains if the mail piece contains the marking "AUTO" or an abbreviation of AUTO. Pieces with AUTO markings are counted as Automation mail. About half of the First-Class letter Automation observations or tallies have pieces with AUTO markings, though a much lower percentage of the Standard A letter Automation observations have AUTO markings.

The second type of information, from IOCS question 22C (which is relevant for pieces without the AUTO markings), asks the data collector to see if the piece has an address block barcode or a barcode showing through a window in the lower right area of the envelope (the "barcode clear zone"). This question is shown in USPS LR-I-14, page 12-11 for FY 1998 and also in Attachment 1. This question was revised in FY 1999, to request that barcodes be identified as either 9-digit or 11-digit as shown in Attachment 1. For letters and cards, only the 11-digit barcodes are included as Automation, while the 9-digit is Nonautomation. This appears to have lead to a significant shift in our cost estimates from Automation to Nonautomation. About one fourth of the observations or tallies of pieces with an address block barcode or barcode showing through a window were determined to have a 9-digit barcode rather than an 11-digit barcode.

Letter and card automation rates require a "delivery point barcode," which is usually an 11-digit, but not always. From some addresses 9-digit or even 5-digit barcodes are the "delivery point barcode." As a result the FY 1998 method may have understated Nonautomation costs by assigning tallies for pieces with 9-digit barcodes, some of which were not "delivery point barcodes" to Automation. Alternatively, the FY 1999 method may have overstated the costs for Nonautomation by assigning

tallies for pieces with 9-digit barcodes, some of which may be "delivery point barcodes," to Nonautomation.

ATTACHMENT 1

RESPONSE OF THE POSTAL SERVICE TO QUESTIONS OF COMMISSIONER LE BLANC AT THE HEARINGS OF 8/3/00 AT TR35/16801-5

FY 1998 and FY 1999 Versions of IOCS Question 22C

FY 1998

```
+-----------+          +-------------------------+              +--------+
|  08/10/00 |----------| IOCS 22C - Version 8.2  |--------------|  14:31 |
+-----------+          +-------------------------+              +--------+

 +-------------------------------------------------------------------+
 | AUTOMATION RATE BARCODE (ADDRESS BLOCK OR INSERT ONLY)            |
 |                                                                   |
 | Does the mailpiece have a 9- OR 11-DIGIT BARCODE that appears     |
 | either in the ADDRESS BLOCK or on an INSERT showing through a     |
 | window in the lower right area ("clear zone") of the envelope?    |
 |                                                                   |
 |                            (Y/N)  [_]                             |
 +-------------------------------------------------------------------+
```

FY 1999

```
+-------------+       +-------------------------+           +--------+
|  08/10/2000 |-------| IOCS 22C - Version 9.2  |-----------|  14:30 |
+-------------+       +-------------------------+           +--------+

    +-------------------------------------------------------------------+
    | AUTOMATION RATE BARCODE (ADDRESS BLOCK or INSERT ONLY)            |
    |                                                                   |
    | Examine the mailpiece for a mailer applied automation rate        |
    | barcode. This should be a 9- or 11-DIGIT BARCODE that appears     |
    | either in the ADDRESS BLOCK or on an INSERT showing through a     |
    | window in the lower right area ("clear zone") of the envelope.    |
    | A barcode applied by the Postal Service is not an automation      |
    | rate barcode and should be recorded as choice "C" below.          |
    |                                                                   |
    | Determine the barcode type by counting the barcode's 'high bars'. |
    | What type of barcode is on the mailpiece?                         |
    |                                                                   |
    |            A.  9-Digit barcode  (22 high bars counted)            |
    |            B.  11-Digit barcode (26 high bars counted)            |
    |            C.  No automation rate barcode                         |
    +-------------------------------------------------------------------+
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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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